No. 54 and 55.

Bf. of Oldham for Appt.

Supreme Court of the United States.

October Term, 1898.

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T. B. Merrill, as Receiver of The First National Bank of Palatka, Appellant,

No. 54. vs.

The National Bank of Jacksonville.

T. B. Merrill, as Receiver of The First National Bank of Palatka, Appellant,

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The National Bank of Jacksonville.

APPEALS FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH DISTRICT.

ARGUMENT AS TO APPLICATION OF COLLATERALS ON BEHALF OF APPELLANT.

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(16,486 and 16,487.)

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SUPREME COURT OF THE UNITED STATES.

T. B. MERRILL, as Receiver of The First National Bank of Palatka, *Appellant*,

vs.

THE NATIONAL BANK OF JACKSONVILLE.

No. 54.

T. B. MERRILL, as Receiver of The First National Bank of Palatka. *Appellant*,

vs.

THE NATIONAL BANK OF JACKSONVILLE.

No. 55.

APPEALS FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH DISTRICT.

STATEMENT OF THE CASE.

On the 17th day of July, A. D. 1891, The First National Bank of Palatka, a banking association incorporated under the laws of the United States, and having its place of busi-

ness at Palatka, Florida, failed and closed its doors. Subsequently T. B. Merrill, the appellant, was duly appointed receiver of said bank by the Comptroller of the Currency and entered upon the discharge of his duties. At the time of the failure of said bank it was indebted to The National Bank of Jacksonville, the appellee, in the sum of $6,010.47 for sundry drafts of The First National Bank of Palatka to the order of the appellee on the Hanover National Bank of New York, which indebtedness was unsecured, also in the sum of $10,000.00 and interest, for money borrowed June 5, 1891, which indebtedness was evidenced by a certificate of deposit and was secured by sundry notes belonging to The First National Bank of Palatka, attached to said certificate as collateral security. Said notes aggregated in amount $10,896.22, the largest being made by A. L. Hart for the sum of $5,350.22.

The appellee proved its claims upon the unsecured drafts for $6,010.47, as to which there is no controversy. It also offered to prove its claim for $10,000, being amount of certificate of deposit secured by collaterals, but the receiver would not permit the appellee to prove the full amount, but, under the ruling of the Comptroller of the Currency, the appellee was ordered first to exhaust the collaterals given to secure the certificate of deposit, and then to prove for the balance due after applying the proceeds of the collaterals in part payment. This was done. The appellee collected all the notes, except that of A. L. Hart, obtained a judgment upon the said note of A. L. Hart, which it assigned and transferred to the receiver, applied the proceeds of the collaterals which it had collected to its claim on the certificate, and proved only for the balance due thereon, being the sum of $4,496.44. On December 1,

1892, a dividend of $1,573.75 was paid on said claim, and on May 17, 1893, a second dividend of $449.64 was paid.

The Bill of Complaint, filed September 11, 1894, in the Circuit Court of the United States in and for the Southern District of Florida by the appellee herein against the appellant, sets forth all the foregoing facts and complains of the action of the receiver in not permitting proof for the full amount of the certificate of deposit, and alleges that the appellee "gave due notice that it would demand a *pro rata* dividend upon the whole amount due . . . without deducting the amount collected on collateral security, to wit: that it would demand a *pro rata* dividend upon $16,103.81, and interest thereon from the 17th day of July, A. D. 1891." The prayer of the bill is for, among other things, a *pro rata* distribution upon the entire amount of indebtedness. (Record, pp. 1–5.)

The oath of defendant was not waived in the bill of complaint, but he was required to answer upon his corporal oath. The defendant demurred to the bill as not containing any matter of equity, and as seeking to make proof of complainant's claim for the full amount, without deducting amounts received from proceeds of collateral securities collected prior to making proof. The demurrer was overruled by the court. (Record, p. 7.)

The answer of T. B. Merrill, as Receiver of The First National Bank of Palatka, to the said bill of complaint denies "that the complainant gave due notice that it would demand a *pro rata* dividend upon the whole amount due to it, without deducting the amount collected on collateral security." It avers that "the complainant accepted the said ruling of the said comptroller without demur, and accepted from the said comptroller, through this defendant, without protesting notice of any kind, the checks of the

said comptroller in payment of the dividends mentioned in the bill, and that it was not until the 15th of March, 1894, that the complainant gave notice of any kind that it dissented from the said ruling of the comptroller and would demand payment upon a different basis." The answer was duly sworn to. (Record, pp. 9–11.)

Sundry exceptions were taken to the answer for insufficiency, which were overruled, and the cause was set down for final hearing upon the bill and answer. (Record, p. 17.)

The Circuit Court adjudged that the complainant is entitled to a distributive share and dividend as one of the creditors of said First National Bank of Palatka, based upon, and to be calculated upon, the whole amount of the indebtedness due July 17, 1891. (Record, p. 17.)

The cause was appealed by the receiver to the United States Circuit Court of Appeals for the Fifth Circuit, where, June 15, 1896, it was reversed on account of the form of the decree and method of calculating interest, but said Circuit Court of Appeals affirmed the judgment of the Circuit Court as to the right of The National Bank of Jacksonville to be allowed dividends upon the full amount of the certificate of indebtedness, without regard to the collaterals, provided that the dividends paid and to be paid, together with the amounts received on the collaterals, should not exceed one hundred cents on the dollar on the principal and interest of said indebtedness. The receiver appealed from this decree of the Circuit Court of Appeals to this court, which appeal is numbered 16,486. (Record, p. 22.) A mandate was issued to the Circuit Court for the Southern District of Florida for further proceedings in accordance with said decree of the Circuit

Court of Appeals. (Record, No. 16,487, pp. 21–23.) A decree similar to the former decree, so far as it relates to the matter of collateral security, was entered by the Circuit Court on the 27th day of July, A. D. 1896. (Record, No. 16,487, pp. 23, 24.) From this decree a second appeal was taken to the Circuit Court of Appeals, Fifth Circuit, by the receiver, which was dismissed by the Court, December 8, 1896. (Record, No. 16,487, p. 30.) The Receiver of The First National Bank of Palatka has appealed also from said decree of dismissal to this court, which cause is numbered 16,487. (Record, p. 30.)

SPECIFICATION OF ERRORS.

It is the desire of the Comptroller of the Currency that the question as to the right of The National Bank of Jacksonville to participate in the distribution of the assets of The First National Bank of Palatka, as a creditor for the full amount of its claim on the certificate of indebtedness, notwithstanding its receipt of proceeds realized from collaterals after the failure of The National Bank of Palatka, may be presented by separate brief.

It is respectfully submitted that the Circuit Court and the Circuit Court of Appeals erred in not requiring the receiver to recognize The National Bank of Jacksonville as a creditor on said certificate of indebtedness, only for the amount due thereon after crediting thereon the proceeds of collaterals realized after the insolvency of The First National Bank of Palatka, and to pay it dividends accordingly.

ARGUMENT.

I.

The appellee is precluded by its conduct from claiming dividends upon the full amount of its certificate of indebtedness.

The Bill of Complaint avers that, when the appellee offered to prove its claim for the full amount of the certificate of indebtedness, the receiver, under the ruling of the Comptroller of the Currency, would not permit it to do so, but the claimant was "ordered to first exhaust the collateral given to secure said loan for $10,000, and then to prove the claim for the difference between the amount of the loan and interest and the amount realized from the collateral." This it did, and received dividends on the claim as proved. (Record, p. 3.) While it is averred in the bill that "your orator gave due notice that it would demand a *pro rata* dividend upon the whole amount," the answer, under oath not waived, says no objection was made to the ruling of the comptroller, and no notice of any demand for payment on a different basis was given until March 15, 1894. (Record, p. 9.)

This was not merely a waiver of appellee's right to prove for the full amount, if any such right existed, it was more.

The creditors of an insolvent national bank in the hands of a receiver are notified by the comptroller to present

their claims and make legal proof thereof. (U. S. Revised Statutes, Sec. 5235.) After provision has been made for refunding to the United States any deficiency in redeeming the bank's notes, the comptroller "shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction." (*Ib.*, Sec. 5236.)

The claim, as appellee offered to prove it, was one concerning which the authorities are much in conflict. Rather than resort to a court of competent jurisdiction to establish its validity in the form desired, appellee elected to obtain a standing as a creditor by the satisfaction of the comptroller. By so doing it became, without litigation, the holder of a claim having all the force, validity and advantages of a *judgment.* As against The First National Bank of Palatka, the claim as proved became entitled to interest from the time it was proved to the satisfaction of the comptroller, the same as if adjudicated by a State, or United States, court.

National Bank of the Commonwealth v. Mechanics' National Bank, 94 U. S. 437.

In the case cited, referring to the claim of depositors to be paid interest in full on their claims, the assets being sufficient, Mr. Justice Swayne says, p. 439: "If these claims had been put in judgment, whether in a court of the United States or in a State court of that State, the result as to interest upon the judgment would have been the same. It was unnecessary to reduce them to judgment because they were proved to the satisfaction of the comptroller. After they were so proved they were of the same efficacy as judgments, and occupied the same legal ground."

Having voluntarily credited the proceeds of its collateral

in order to obtain the advantages of a judgment, appellee is estopped upon equitable principles from shifting its position.

One who obtains or defeats a judgment by pleading or representing an act in one aspect will be precluded from giving it a different and inconsistent character in a subsequent suit upon the same subject.

P. W. & B. R. Co. v. Howard, 13 Howard, *307, *337.

Martin v. Boyle, 49 Mich. 122.

Hooker v. Hubbard, 102 Mass. 239.

Perkins v. Jones, 602 Iowa, 345.

The same principle applies to awards upon matters in controversy submitted by the parties.

1 Freeman on Judgments, Sec. 320.

II.

If appellee is not estopped to assert a right to share as a creditor upon the full amount of its claim, the question is presented, whether a creditor, who is secured by collateral realized upon after insolvency of a national bank but before proving his claim, is required to credit upon his claim the amount so realized, or may he prove for the full amount, reserving the proceeds of his collateral to pay the balance due after crediting any dividends he may receive. As the facts appear from the Bill of Complaint, all the collateral notes, except that of A. L. Hart, were collected before actual proof was made. (Record, p. 3.)

Upon the general subject of the right of creditors holding collateral or mortgage security to participate in the distribution of insolvent estates, the authorities are in irreconcilable conflict. The subject has never been expressly considered in this court, although it seems to have been involved in The Cook Co. National Bank v. The United States, 107 U. S. 445, nor do the statutes relating to the distribution of the assets of insolvent national banks indicate any definite intention of Congress on the subject. The comptroller is simply required to "make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction." U. S. Revised Statutes, Sec. 5236.

In the absence of statutory provision, there seems to be no substantial reason for any distinction in determining the rights of such creditors in the administration of insolvent estates, whether the insolvent is deceased, or has been adjudged a bankrupt, or has made an assignment for the benefit of his creditors, or is a corporation being wound up by the agency of a statutory or judicially appointed receiver. In all these cases the question is, what is the just and equitable amount of the claim which a creditor holding collateral security has as against a fund for distribution among creditors?

In discussing the subject in the light of the authorities, I shall assume, except where otherwise mentioned, that there is a single debtor, and that the security held was given by the debtor and not by a third person.

Decisions of greater or less weight can be found in support of each of the four following rules of distribution.

Rule 1. The creditor desiring to participate in the fund is required first to exhaust his security and credit the proceeds on his claim, or to credit its value upon his claim and prove for the balance, it being optional with him to surrender his security and prove for his full claim. This is known as the rule in bankruptcy, but has been followed by courts of high authority in many analogous cases.

Rule 2. The creditor can *prove* for the full amount, but shall receive *dividends* only on the amount due him at the *time of distribution* of the fund; that is, he is required to credit on his claim, as proved, all sums received from his security, and may receive dividends based only on the balance due him. This is the rule in several States and in Canada.

Rule 3. The creditor shall be allowed to prove for, and receive dividends upon, the amount due him *at the time of proving* or sending in his claim to the official liquidator, being required to credit as payments all sums received from his security prior thereto. This is the English rule, and is followed in many cases in the United States.

Rule 4. The creditor can prove for, and receive dividends upon, the full amount of his claim, regardless of any sums received from his collateral after the transfer of the assets from the debtor in insolvency, provided that he shall not receive more than the full amount due him. This was the rule adopted by the lower courts in the case at bar, following the opinion of Judge Taft in The Chemical National Bank v. Armstrong, 59 Fed. 372.

The correctness of the judgment we are seeking to reverse depends on the validity of the fourth rule above stated. The first rule includes the second, and the second includes the third. If the creditor should be required first to exhaust or credit his security before proving his claim, *a fortiori* should he be permitted to share in the distribution only on the basis of the amount then due him, and if the amount due at the time of distribution is the proper criterion of his rights, *a fortiori* should he be required to credit on his claim such amounts as he has already received from his security prior to making proof. So far, then, as the argument of this case is concerned, the authorities divide themselves into those that favor the fourth rule and those that oppose it.

I shall attempt to show that the first, second and third rules are each more reasonable than the fourth; that the reasoning upon which it is founded is not only technical, but fallacious; that it is contrary to the weight of authority, and that it was not suggested by counsel or considered by this honorable court in an important case (Cook County National Bank v. The United States, *supra*), where its application would have materially affected the result.

If a debtor in failing circumstances desires to prefer a creditor, equity permits him to do so. It does not encourage or favor the transaction. If the debtor tenders the creditor a $1,000 bond in part payment of his claim it may be lawfully accepted and credited. If the creditor refuses to accept the bond as payment, but requests it as security,

the debtor may accede to such request. The same is true if, instead of a $1,000 bond, the debtor tenders $1,000 in money, for money can be specifically deposited as security. If the fourth rule is sound, the creditor is wise in refusing to accept it as *payment.* By taking the bond or money *as security* he can hold it back to supplement dividends on his full claim. That is to say, a *limited interest in property, taken out of what would otherwise have been assets for all, is worth more to him than absolute ownership in the same property.* The excess of value to him in the limited over the absolute ownership measures the unfair advantage which this fourth rule enables him to obtain over the other creditors.

Again, suppose that C, in failing circumstances, borrows of A $1,000, giving him collateral security of the value of $500, and borrows of B $1,000, without security. Here A increases the assets soon to be conveyed to a trustee by $500; B increases them by $1,000. If C's trustee is able to pay fifty cents on the dollar, A will receive payment in full, while B will receive only $500. If, by misfortune or otherwise, the assets had been entirely lost, by such loss A would lose $500, while B would lose $1,000. B's *risk* in such assets is twice as great as A's. It would seem but just for them to share in the distribution of the assets in the same ratio they would lose if there were none. As A's claim was secured by collateral having only half the value of the claim, it was *practically* only half secured. Equity is practical.

Much has been said about his caution in taking security deserving to receive its *full reward.* Under the operation of this rule, A, in the case supposed, who has taken security sufficient to pay only one half of his claim, fares as

well as the creditor who has taken full security. If caution is to be rewarded, the measure of reward ought to be proportionate to the amount of caution exercised.

The first rule, therefore, requiring the creditor to realize upon his security or credit its value, before recognizing him as a creditor having an equitable claim upon the assets, seems reasonable.

The second rule is, perhaps, more just than the first, when the collateral security can not be enforced before settlement of the insolvent estate, and the creditor has no power of sale. It obviates the objection of an enforced sale of the collateral, by valuation, to the secured creditor. It is based on the seemingly just principle that a fund to be distributed among creditors ought to be shared by them in proportion to the amounts due them respectively at the *time of distribution.* It is a corollary of the well-established principle which permits claims, growing out of a liability which was contingent at the time of the transfer of the assets to an assignee for the benefit of creditors, to share in such assets if the contingency happens before time of distribution.

Sweatman's Appeal, 150 Pa. St. 369.
Suppiger v. Gruaz, 137 Ill. 216.
Smith v. Goodman, 149 Ill. 75.
Parker v. Hull, 46 Ill. App. 472.
Hoyle v. Scudder, 32 Mo. App. 372.
Rea v. Jaffray & Co., 82 Iowa, 231.
Matter of Ives, 25 Abb. N. C. 63.

It is self-evident that, if a creditor of an insolvent debtor, after assignment but before dividend, should be fully paid

by the insolvent debtor out of his exemptions or future earnings, such creditor ought not to participate in the distribution. The cases above cited, as well as those hereafter cited directly in support of the second rule, regard *equal distribution among creditors having meritorious claims at the time of distribution* as the *paramount* object of the law, and treat as immaterial the amount of the claim at any time while the machinery of the law is in operation to accomplish its final purpose.

The chief merit of the third rule, as compared with the second, seems to be to lighten the labor of the liquidating officer. It fixes the amount of the claim as a basis for dividends, as it exists when proof is made, thereby rendering distribution mathematically more easy, but equitably more unjust. It is superior to the fourth rule in that it does not permit the creditor to make proof for the full amount of his claim when he has actually received part of it by realizing upon his collateral.

In regard to the fourth rule, it is said on behalf of the creditor holding collateral (1) that such collateral is simply *security* for the debt; that the creditor has the right, as against the debtor, to hold the security until the whole debt is paid; that he can sue the debtor personally, obtain judgment, levy execution upon his property, and reserve his collateral to realize any balance of his claim not collectible from the debtor's general property. Why, it is asked, should not his right be the same as against the receiver or

assignee in insolvency? His right to follow such property by execution is taken away by the transfer. He is deprived of the same right as other general creditors, and should have the same substituted right against the assets in the official liquidator's hands as other creditors.

Again, it is said (2) that, by the transfer, an equitable fund is created, of which the creditors are the equitable owners. Each creditor becomes an existing owner of a fractional share, the numerator of which is his claim *as it exists at the time of the transfer*, and the denominator of which is the aggregate of all the claims against the estate. Why should such ownership be affected by the receipt of money arising from his collateral, provided the amount received and the dividends do not more than pay his claim in full?

Furthermore, it is said (3) the collateral secures each and every dollar of his claim; so does the fund in the hands of the official liquidator; he therefore has a right to accept all he can get from either source and apply it on that part of his claim not paid from the other source.

Referring to the first argument, it entirely ignores certain duties arising from implied obligation on the part of the holder of collateral. It is true that, as between creditor and debtor, the creditor holding collaterals is not bound to resort to them or credit their value on his claim before enforcing his direct remedies against the debtor. Lewis, Trustee v. U. S., 92 U. S. 618, 623. But there is a third party interested, the party who is indebted upon the collateral. He has both a *right* and a *duty* to pay such collateral when it is due. The only person authorized to

receive payment is the holder of the collateral. It is his *duty* also to receive payment of the collateral when it is due and payment is tendered by the debtor upon the collateral.

Greenway v. Orthwein Grain Co., 85 Fed. 536.

What shall the creditor do with the proceeds of the collateral if it is less than the amount of his secured debt and is paid when the collateral falls due before the maturity of such debt? On the one hand, he is not bound ordinarily to accept payment of his claim, either before maturity or in installments. But here is money, perhaps a large sum, received by him through the very instrumentality by which he impliedly agreed to receive it by accepting the collateral. He must necessarily hold this money. Shall its use be lost? Shall he keep it intact in his own house or pocket (for if he deposits it in bank in his own name it becomes his own), or does the law apply it in part payment of his claim? If A owes B $1,000 not due, and B receives $900 of A's money applicable to the payment of the $1,000, it must be presumed that they did not intend that B should hold the $900 and still continue to draw interest upon the $1,000. And so the authorities hold.

Hunt v. Nevers, 15 Pick. 500.
Marine Bank v. Vail, 6 Bosw. 421.
Midgeley v. Slocomb, 32 How. Pr. 423.
Union Trust Co. v. Rigdon, 93 Ill. 458.
Joliet Iron Co. v. Scioto F. B. Co., 82 Ill. 548.
Cooper v. The Molson's Bank, 26 S. C. Can. 611.
Lamberton v. Windom, 12 Minn. 232.
Benning v. Thibaudeau, 20 Can. S. C. 110.
Thompson v. Hudson, L. R. 10 Eq. 497.
Assigned Estate of Wilhelm, 182 Pa. St. 281.

In Hunt v. Nevers, Chief Justice Shaw says, p. 504:

"It is a general rule that where collateral security is received for a debt, with power to convert the security into money, this is specifically applicable to the payment of such debt; the same person being the party to pay and receive, no act is necessary, and the law makes the application; if the proceeds equal or exceed the amount of the debt, it is *de facto* paid; no action would lie for it, and proof of these facts would support the defense of payment. It is like the ordinary case of a banker or factor, receiving securities of his principals, by indorsement or otherwise, on which he has a lien for his advances; when received, the proceeds operate as payment *pro tanto.*"

In Midgeley v. Slocomb, 32 How. Pr. 423, it is held that when a creditor who is secured by collateral realizes thereon it operates by law as payment *pro tanto*, and must therefore be *credited.*

The court say, in Joliet Iron Co. v. Scioto F. B. Co., 82 Ill., p. 549:

"The pledge of commercial paper as collateral security for the payment of a debt does not, in the absence of a special power for that purpose, authorize the party to whom such paper is so pledged to sell the securities so pledged upon default of payment, either at public or private sale. He is bound to hold and collect the same as it becomes due and apply the net proceeds to the payment of the debt so secured."

The quotation is repeated and approved in Union Trust Co. v. Rigdon, 93 Ill. on page 465.

In Lamberton v. Windom, 12 Minn. 232, the court say, p. 242, with italics: "The contract carries with it an implication that the security shall be made *effectual to discharge the obligation.*"

In Cooper v. Molson's Bank, 26 S. C. Can. 611, Sir

Henry Strong says, p. 625: "Had I not been successful in finding an authority directly in point, I should, however, nevertheless have considered that a creditor who takes a collateral for less than the amount of his debt impliedly agrees that the money realized from such security shall be treated as a partial payment."

In Thompson v. Hudson, L. R. 10 Eq. 497, Sir Roundell Palmer argued that a mortgagee is not bound to receive payment in driblets, but Lord Romilly, M. R., shows the injustice of allowing a creditor to collect and hold money and yet charge interest for the full amount of his debt. In both the last-mentioned cases the creditor undertook to put the proceeds of collateral into a "suspense account."

In Colebrook on Collateral Security, Sec. 85, p. 169, it is said the *primary* purpose of collateral is to place in the hands of the creditor the means of reimbursement if default be made in payment of the principal indebtedness; and in Sec. 87 it is said the pledgee's duty is to apply the proceeds of the collateral when collected in payment of the principal debt.

In the Assigned Estate of Wilhelm, 182 Pa. St. 281, the assignee (a corporation) of an insolvent debtor was also one of the creditors, holding a promissory note for $15,000. The assignee held, as collateral security, stock, which it sold for $1,662.08, and a judgment, which it also realized by execution. It undertook to *hold* the proceeds without crediting them, so as to get more interest, but the court said, p. 283: "The company sold the stock held as collateral not as assignee, but as pledgee. Its power under the terms of the pledge was to sell and apply the proceeds to the payment of the note. This power it exercised, and it was bound to apply the proceeds at once. It

could not, after converting the stock into money, hold the money as collateral and allow interest to run on the note. The power to sell was that it might pay the note, and when it sold and received the money its claim to that extent was *extinguished.*"

Now, while it is not contended by the advocates for the collaterally secured creditor that if any collateral is *in fact* collected *before insolvency* it should not be deducted from his provable claim, yet no consideration has been given to the principle that equity considers that as done which ought to be done. If it is the debtor's duty to pay when the debt is due, and the creditor's duty to apply the proceeds on his claim, no reason is apparent why equity should not require these duties to be performed, if other general creditors will suffer from their non-performance.

In the case at bar it does not appear when the collateral notes became due. The appellee must be presumed to have set forth in its Bill of Complaint all the equities in its favor. The receiver and comptroller must be presumed to have done their duty. If the collateral notes described on page 2 of the record were due before the failure of The First National Bank of Palatka, then, at least, I submit the comptroller was right in requiring them to be collected and applied, as was done.

But, even if the collateral is not due before the insolvency or before proof is made of the creditor's claim, I respectfully submit it does not follow that, because the creditor has certain rights against the debtor, he has simi-

lar rights as against the fund. The argument overlooks the rights of other creditors. In the absence of legislation, what is the just amount of a creditor's claim against an equitable fund depends upon equitable principles. The creditor of a firm can follow the partner's individual property, but not when equity is administering insolvent firm and individual property. The whole doctrine of marshaling securities is opposed to the argument.

It is said, however, that equity will not require a creditor who has a lien on two funds to resort to one of such funds rather than the other, in favor of creditors having liens only on the latter, *when such requirement will result in loss to the creditor.* I respectfully submit that such argument begs the question, which is, *what is the amount* of the lien or equitable claim which the holder of security has as against the insolvent estate of his debtor?

Referring to the argument (2) that the creditor who holds collateral security has an equitable interest in the assets of the insolvent proportionate to the ratio his entire claim bears to the entire indebtedness, I respectfully submit that it is open to the same objection. It assumes that such creditor has a lien upon the fund for the entire amount of his claim, regardless of any amount that may be paid to him before he proves his claim.

He may elect never to pursue the fund. He may be satisfied with his collateral. Even an unsecured creditor may prefer to pursue an insolvent debtor personally rather than to share in his estate. In such event he does not *waive* his lien. He never acquires any. The law does not force liens upon creditors. It offers them an interest

in the nature of a lien, which they may accept by presenting to the official liquidator just and equitable claims.

A technical argument should at least be technically exact. If the creditor has an interest of such an exact nature at the time of the insolvency that it is inequitable to disturb it, such interest should be susceptible of measurement. The numerator only of the fraction is determinable. What the aggregate of claims is, or will be, is necessarily uncertain. Claims arising on contract but unliquidated at the time of insolvency, as well as claims arising out of a contingent liability which becomes absolute after the insolvency, are provable. Courts are liberal in permitting claims to participate in the distribution which had only an embryotic existence at the time of the transfer of the assets from the insolvent, as the authorities already cited show. By parity of reasoning they should be equally liberal in excluding or modifying claims the status of which has been changed between insolvency and distribution.

The argument (3) that every dollar of the creditor's claim is secured, both by the collateral and by the assets, and that therefore he can hold back what is realized from the collateral to apply in payment of any deficiency after full distribution of the assets, contains the same latent fallacy. It assumes that he has the same equitable interest in the assets, regardless of his collateral, or any payments to be made thereon, as an unsecured creditor.

That the right of the creditors in the assets is not measured by their claims against the *debtor* is shown by the matter of interest. Interest is allowed against the assets, if they are insufficient to pay the creditors, only to the date of insolvency.

White v. Knox, 111 U. S. 784.

If the assets are sufficient to pay the creditors in full, interest in full is to be paid *out of the assets* to date of payment. The date of insolvency is fixed because it is obviously just to the creditors *inter sese*. A creditor to whom the debtor had promised ten percent would have an unjust advantage over one whose claim was only drawing five percent, arising from necessary delay in the settlement of the estate. The date is fixed, not by statute, but by the courts, and by them, not for the technical reason that the trust is created at that time, but for the equitable reason that all the creditors should be treated alike and no one prejudiced by the law's delay.

The real question therefore is, what is a just and equitable rule for distributing the funds of an insolvent estate as between general creditors and those holding security?

The rule established by the courts under the earliest English Bankrupt Acts treated the interest of the holder of collateral security in the assets of the estate as it really and practically is. That is to say, if the creditor's security is ample, the bankruptcy of the debtor is a matter of indifference to him. He is interested in it to the extent that his security fails to secure him. He has a lien secured by his own vigilance, and the full amount of this lien not exceeding his claim was given to him by the court. He had not by vigilance secured any interest in the assets. It seemed just to the courts that, inasmuch as he had a lien, before they would give him another they should require him to exhaust or account for the one already held by him.

This idea of justice prevailed since the Act of 13 Elizabeth C. 7, and was approved and followed by the courts in bankruptcy in the United States without any statutory provision until the Bankrupt Act of 1867. That act embodied the rule in the statute.

One of the leading English cases under the "Winding-Up Acts" is Kellock's Case, L. R., 3 Chancery App. Cas. 769. Sir W. Page Wood, L. J., says, p. 778, the clause relating to distribution in the "Companies Act" of 1862 is "'equal distribution is to be made amongst creditors,' an expression similar to which in 13 Eliz. Ch. 7, appears to have led to the rule in bankruptcy." The learned Justice then shows that the earlier "Winding-Up Acts" expressly provide, p. 778, "that administration is to be according to the course in bankruptcy." This provision having been omitted in the later acts, including the Act of 1862, then under consideration, it was held that dividends should be paid to the holder of the collateral based upon the amount due to him at the time when his claim was sent in to the official liquidator.

This idea of justice is sufficient for our purposes in this case, but it was not acceptable to Parliament, which, in 1875, by the tenth section of the Judicature Act, re-established the rule in bankruptcy as the proper one to be followed in winding up companies. Mr. Lindley says the main object of the section was to place secured and unsecured creditors in the same position as in bankruptcy.

Lindley on Companies (5th Ed.), pp. 719, 720.

In 1813, Lord Eldon said, in *Ex parte* Smith, 2 Rose, 63, on p. 64:

"The practice has been long established in bankruptcy not to suffer a creditor holding a security to prove, unless

he will give up that security, or the value has been ascertained by the sale of it. The reason is obvious: till his debt has been reduced by the proceeds of that sale, it is impossible correctly to say what the actual amount of it is, and with this further consideration that, in the event of any doubt attaching upon his right to retain the security, he is enabled in a contest with the rest of the creditors to sustain his title in a situation of predominate advantage."

The distinguished Lord Chancellor's idea of the right of such creditor to participate in the bankrupt's assets so completely excluded the portion of his claim practically secured, that he terms the provable portion of the claim the "actual amount."

As has been tersely expressed, a creditor was not permitted in bankruptcy to claim both a whole of the part and a part of the whole. Such was the rule also in the United States, without any provision of statute, under the Bankruptcy Law of 1841. The Bankruptcy Acts of 1867 and 1898 expressly provide for the application of the rule, as does the present English Bankruptcy Act.

In addition to its approval on its merits by the courts of bankruptcy in this country and England, and by the legislation of Congress and Parliament and the legislatures of many of the States, the rule has been followed and approved in the following cases:

In re Frasch, 5 Wash. 344.
Moore v. Dunn's Adm'r, 92 N. C. 63.
Creecy v. Pearce, 69 N. C. 67.
Wurtz v. Hart, 13 Iowa, 515.
Willis v. Holland, Tex. Civ. App. (1896) 36 S. W. 329.
Bell v. Fleming's Executor, 1 Beasley, 13.

Field's Ex'r v. Creditors of Wheatley, 1 Snead, 351.

Winton v. Eldridge, 3 Head, 361.

Nat'l Union Bank of Md. v. Nat'l Mechanics' Bank of Balt., 80 Md. 371.

Amory v. Francis, 16 Mass. 308.

Farnum v. Boutelle, Adm'r, 13 Met. 159.

Middlesex Bank v. Minot, Adm'r, 4 Met. 325.

Haverhill Loan & Trust Co. v. Cronin, 4 Allen, 141.

Merchants' Nat'l Bank v. Eastern R. Co., 124 Mass. 518.

The American Nat'l Bank v. Branch, 57 Kans. 27.

The Security Investment Co. v. Richmond Nat'l Bank, 58 Kans. 414.

In re Frasch, Judge Dunbar, who pronounced the opinion, commenting on the rule that a creditor will not first be required to resort to one fund when he has a lien on two to his prejudice, says, p. 347: "But does he lose anything which was rightfully his by reason of his security, by compelling him first to exhaust his security and diminish his claim before he is allowed to resort to the general fund? We think not. Under this theory of the law" (the opposite rule) "a secured creditor is given an undue advantage of the unsecured creditors. Instead of being deprived of any of the benefits of his security, he is allowed their benefit in full, and in addition is allowed to use the security as an instrument to operate on and affect to his advantage the unsecured property."

In Moore v. Dunn's Adm'r, 92 N. C. 63, it is held that a mortgage creditor of a decedent must first exhaust his mortgage and look to the personalty for the residue. The

case follows and approves Creecy v. Pearce, 69 N. C. 67, where it is expressly held that the residue, after exhausting the mortgage, is to be paid ratably with other claims.

Wurtz v. Hart, 13 Iowa, 515, was an assignment case, and applies the rule without any limitation. It is expressly approved in Doolittle v. Smith (Sup. Ct. Iowa, Jan. 21, 1898), 73 N. W. 867.

Willis v. Holland, 36 S. W. 329, was a case where an insolvent debtor had made a conveyance to a trustee in trust to pay certain of his debts. The court say, p. 331, that such creditors have a right to have security held by one applied to his debt before he will be allowed to participate. It must be inferred that participation would be only upon the balance.

In Bell v. Fleming's Ex'rs, 1 Beasley, 13, Chancellor Williamson approves the rule on the broad ground that equality is equity.

In Field's Ex'r v. Creditors of Wheatley, 1 Snead, 351, and Winton v. Eldridge, 3 Head, 361, it is held that mortgage creditors of a decedent must first exhaust the mortgage, and for balance share *pro rata* with other creditors in the personalty.

The court in the recent case of Nat'l Union Bank of Maryland v. Mechanics' Bank of Baltimore, 80 Md. 371, not only approve as "just and equitable" the rule that distribution should be made on the basis of the amount then due, but require the secured creditor to exhaust or deduct the value of his security before proving his claim. It was a case of an assignment for the benefit of creditors, and much stress is laid on the inconvenience of permitting the secured creditor to participate for the full amount of his claim in the assets and afterwards to collect the full amount of his

collateral, with all the risk of his own insolvency when called upon by the assignee, from whom he has received dividends, to refund the excess above full payment.

In Amory v. Francis, 16 Mass. 308, Chief Justice Parker approves the rule in bankruptcy "as just and equitable." He says, p. 311 (italics mine): "This rule was adopted in England on account of its reasonableness and because consistent with the nature of the contract. For the property pledged is *in fact* security for no more of the debt than its value will amount to, and for all the rest the creditor relies upon the personal credit of his debtor in the same manner he would for the whole if no security were taken."

Farnum v. Boutelle, Adm'r, 13 Met. 159, decided in 1847, involved the right of a creditor holding a chattel mortgage to prove a claim against the estate of a decedent. Chief Justice Shaw pronounced the opinion. On page 164 he says: "If the mortgage remained in force at the time of the decease of the debtor, then it is very clear, as well upon principle as authority, that the creditors can not prove their debt without first waiving their mortgage, or in some mode applying the amount thereof to the reduction of the debt, and then proving only for the balance." There is no statute referred to, but Amory v. Francis is cited.

The same principle was approved in Middlesex Bank v. Minot, Adm'r, 4 Met. 325, without reference to statute, and in 1862, in Haverhill Loan & Fund Ass. v. Cronin, 4 Allen, 141, the same principle was held in the case of a mortgagee of real estate. Judge Hoar, on page 144, says it has been repeatedly so held in Massachusetts, citing Amory v. Francis and other cases.

In Merchants' Nat'l Bank v. Eastern R. R. Co., 124 Mass. 518, a statute was construed which authorized a

corporation to mortgage its property, etc., to secure its indebtedness. The trustees were to deliver certificates "in exchange for its existing debts and obligations to an equal amount as the same shall be ascertained and liquidated" by the trustees. The court say, p. 522: "There are no expressions in the act as to the extent or amount for which creditors whose debts are partially secured shall receive certificates." It is held, p. 524, that the holder of collateral is bound to deduct its value and receive certificate for the balance, approving Amory v. Francis.

In both of the Kansas cases the question arose under assignments for the benefit of creditors. In The American National Bank v. Branch, 57 Kans. 27, the court say, p. 35: "It would be inequitable to allow these claimants a *pro rata* dividend on the whole amount of their claims when payment of a part, if not all, of it may be received from the mortgage securities to which they have the exclusive right."

In The Security Investment Co. v. The Richmond National Bank, 58 Kans. 414, the court say, pp. 417, 418: "As the claimants held liens on property other than that assigned, they were not entitled to share equally in dividends with those who held no special security."

The following cases support the second rule, and, while not necessarily requiring the secured creditor to exhaust or value his security before proving his claim, hold that all sums realized from the security *before dividend*, shall be deducted and dividend made only on the basis of the balance due.

West v. Bank of Rutland, 19 Vt. 409.

Lowell v. French, 54 Vt. 193.

Bank v. Alexander, 85 N. C. 352.

Wheeler v. Walton & Whann Co., 72 Fed. 966.

In re Estate McCune, 76 Mo. 200.

Pa. Warehouse Co. v. Anniston Pipe Co., 106 Ala. 357.

London & San F. Bank v. Snell, 83 Fed. 603.

Wheat v. Dingle, 32 S. C. 473.

Third Nat'l Bank v. Lanahan, 66 Md. 461.

Erle v. Lane, 22 Colo. 273.

Whittaker v. Amwell Nat'l Bank, 52 N. J. Eq. 400.

Thibaudeau v. Benning, 20 S. C. Can. 110.

Doolittle v. Smith (Iowa, 1898), 73 N. W. 867.

State of Nebraska v. Nebraska Savings Bank, 40 Neb. 342.

These cases rest upon two propositions, (1) that what is realized from collateral operates as payment *pro tanto* on the principal debt, following the decisions already cited, and (2) that when a fund is to be distributed among creditors the material question is, who are creditors *at the time of the distribution.*

In West v. Bank of Rutland, a bill in equity was filed against a surety, who had received security to indemnify him and had realized upon such security, to compel him to apply the proceeds of the collateral upon the principal debt, so as to reduce the amount to be paid by the insolvent estate of the principal debtor. The bill was dismissed. The case is not directly in point, but Judge Redfield, who delivered the opinion of the court, discusses the right of a *creditor* who holds collateral to share in dividends from his insolvent debtor's estate. He says, p. 408: "One might have a claim against an estate which could not be resisted

at law, and upon which, nevertheless, he is not in equity entitled to a dividend." He further says, p. 409: "It is true that if the security has been converted into money, and it is between debtor and creditor, it ceases to be collateral and operates directly as payment; so that the debt is thereby reduced and the creditor can go only for the balance. This was the only remedy at the civil law. In England and in this country in such case the court of chancery will oftentimes compel the party to apply the funds in his hands and only proceed against the other funds for the balance, and if the proceeds are not money, will require them to be reduced to money."

In Lowell v. French, 54 Vt. 193, the creditor had proved for the full amount against the estate of both principal and surety. A dividend having been afterwards paid from the principal's estate, the creditor was required to deduct it and share only upon the balance in the surety's estate. The court say, p. 199 (italics mine): "In the distribution of an insolvent estate we see no reason why a payment made by the principal after the allowance should not be treated in the same way that it would have been if made before. In both cases the payment reduces the liability of the estate. While it is true that the payees had the right to regard the surety as a principal, and to enforce his liability as a principal until they had obtained full satisfaction, yet, *where there is only a limited fund from which to obtain satisfaction, and the question is made how that fund shall be distributed, creditors whose claims are equal in right are entitled to share equally in such distribution.*"

The case of Bank v. Alexander, 85 N. C. 352, is very similar to Lowell v. French. It is not clear from the report whether a dividend was received from the principal's estate before proof against the surety's estate or before dividend. It was received after *insolvency* of both principal and indorser, and the court required it to be deducted from the claim against the surety's estate.

As against principal and surety, maker and indorser, this was the well-established equitable rule in bankruptcy. A payment by the principal, or from his assets, reduced the claim if made before distribution of the surety's assets, but a payment from the surety's assets was no real reduction of the debt owing by the principal. Hence a just distinction was made when both principal and surety were bankrupts, and the claim was proved against both. The claim upon which dividends were paid from the surety's estate was always reduced by receipt of any sum from the *principal's* estate.

Blumenstiel on Bankruptcy, p. 287.

Ex parte Harris, 16 N. B. R. 432.

In re Babcock, 3 Story, 393.

This was an equitable and not a statutory rule, and goes much further than the rule for which I am contending. Where a creditor has two distinct *debtors* it is not inequitable, perhaps, that he should receive his full claim if the debtors are concurrently insolvent and each pays fifty cents on the dollar, even though such debtors are principal and surety, and some authorities so hold. But where the security has come from the insolvent debtor himself, is property which, if not security, would be part of the assets for general creditors, and property appropriated by both debtor and creditor to at least a potential payment of the debt, the case is much stronger for reduced dividends after part payment of the debt.

Wheeler v. Walton & Whann Co., 72 Fed. 966, was a decision by the Circuit Court of the United States for the District of Delaware. Judge Wales pronounced the opinion. It was a receivership case which is virtually the same, as the court say, so far as the rule for application of

collateral is concerned, as a case of assignment for the benefit of creditors. On page 967 Judge Wales says that by collecting the collateral notes before a dividend is made the creditor must credit the amount received and take a dividend on the balance only. The conflict of authorities is recognized, but in a note by the reporter it is said the court's attention was not called to the case of Levy v. The Chicago National Bank, 158 Ill. 88, hereinafter cited.

In re Estate of McCune, 76 Mo. 200, the question arose in the administration of the assets of an insolvent decedent's estate. The language of their statute is, p. 206: "If there be not sufficient to pay the whole of any one class, such demands shall be paid in proportion to their amounts." Creditors had realized upon their collaterals *after proving* their claims, but *before distribution*. (P. 200.) The court held that conversion of the collaterals into cash operated as payment *pro tanto*, and that dividends should be made on the balance only, and say, p. 206: "Any other construction than this would clearly contravene the plain language and teachings of the statute and result in an inequality of distribution which the statute neither contemplates nor tolerates." On p. 207 the court suggest a query as to the rights of such creditors to participate if they had not collected their collaterals.

Philadelphia Warehouse Co. v. Anniston Pipe Works, 106 Ala. 357, is a case where the assets of an insolvent corporation were in the hands of a receiver. After insolvency and appointment of the receiver the Warehouse Co., a creditor, collected a large sum on its collaterals. Whether such collection was made before or after proving its claim is not clear from the statement of facts, but the court treat that fact as immaterial and approve the rule that

where collaterals are collected before dividend the dividend should be made only on the residue of the claim.

In the London & San Francisco Bank v. Snell, Heitshu & Woodward Co. (U. S. Circuit Court for the District of Oregon), 83 Fed. 603, a receiver was appointed for the company upon the application of the bank, a creditor for a large amount, holding collaterals consisting of book accounts, whose claim had been recognized by the court by an order for payment of interest. Afterwards $7,000 was collected upon the book accounts. The court intimates that the weight of authority, perhaps, does not make the amount due at time of distribution the basis for dividends, but adopts that rule for the reason that the bank had received interest.

In Wheat v. Dingle, 32 S. C. 473, it is held that creditors of an intestate, who have realized upon their liens before dividends to general creditors, can share with such creditors only upon the balance due them. The court distinguish the case from prior cases in South Carolina, applying a different rule where there are *two debtors* bound for one debt, and say, p. 479: "But suppose the payments referred to, instead of having been made by *a third party*, had been made out of *the estate proper* of the debtor himself, would it be for a moment contended that such payments did not release that much of the deceased's assets originally liable to the creditor? It seems to us that such result would not only be in violation of all principle, but entirely unjust."

A recent case in the same state, Ragsdale v. The Winnsboro Bank, 45 S. C. 575, makes a distinction between payments from a principal's estate, after proof filed against both insolvent principal's and surety's estates, and payments from securities that came from the debtor's estate.

The court approves the ruling in Wheat v. Dingle, but shows the very just and equitable distinction between a rule that permits full dividends on the whole amount due when there are *two distinct debtors* (even though principal and surety) and a rule that permits such dividends when the creditòr has received part payment out of the debtor's assets held by the creditor as security. The court say, p. 583 (italics mine): "We understand that the exceptions to so much of his Honor's decree as decided that creditors who hold collateral securities should be paid their *pro rata* dividend, regardless of the amounts they may have collected, or may yet collect, on said collaterals, has been abandoned. *This court, however, does not desire it to be understood that it assents to this rule of distribution.*"

In Third National Bank v. Lanahan, 66 Md. 461, the question arose under an assignment for the benefit of creditors, in which it was provided that the trustee was to pay the creditors in full, if the assets were sufficient, "if not, then ratably and equally, according to their respective amounts." This language (similar to that of the National Bank Act) the court, in a well-considered opinion, held to mean that the proceeds of all collaterals received before dividend should be deducted and dividends paid ratably on the balance. The case is approved in National Union Bank v. National Mechanics' Bank, 80 Md. 371, above cited, which goes further and requires the creditor to exhaust his collateral before proving his claim.

Erle v. Lane, 22 Colo. 273, is a recent, well-considered case, where, after proof against a decedent's estate, collateral was realized upon before distribution. The court of probate had permitted a dividend upon the original amount of the claim. This order was reversed. The court distinguish between cases of assignment for the benefit of cred-

itors and cases of decedent's estates (the statutes of Colorado making creditors in assignments *cestuis que trustent*). On page 279 the court say, after stating that the creditor may prove for the full amount (italics mine): "Yet if, before or *after* the claim is proved, he disposes of the security and realizes thereby a partial payment of the claim, *he has derived all the benefit it was intended to give*, and all that, under his contract, he is entitled to receive, and it no longer exists for any purpose. In other words, if he disposes of his collateral and puts it out of his power to return it in case his debt is paid, it ceases to be collateral, *and the sum realized operates as a payment* and reduces his claim *pro tanto*. By his own voluntary act he parts with the double right the law gives him, and thereafter can proceed only for the remainder of his claim, and is entitled to dividends only on that amount."

Whittaker v. Amwell National Bank, 52 N. J. Eq. 400, involves a large number of questions as to marshaling liens, one of which was the rights of general and secured creditors of one Jonathan Steward, who had assigned for the benefit of his creditors. It is a recent decision (1894) by Vice-Chancellor Bird. He says, p. 418: "Mr. Steward made assignment of certain securities which he held to different creditors as collateral security for their claims. What are their rights as against the general creditors of Mr. Steward? It is my judgment that they may file their claims with the assignee for the whole amount due them, without being compelled, in the first instance, to release their collaterals; but they are only entitled as against general creditors to a dividend out of the assets in the hands of the assignee upon the balance of their claim after having received the value of such collaterals."

The case of Thibaudeau v. Benning, 20 S. C. Can. 110, came up on appeal from the Queen's Bench of Montreal, where it is reported in Montreal L. R., 5 Q. B. 425.

It was a case under an assignment for the benefit of creditors and the question arose under the *common law*, as appears from Chief Justice Dorion's opinion in the Queen's Bench, p. 437. The Queen's Bench held, as expressed in the syllabus: "A creditor who holds notes or merchandise as collateral security is not entitled to be collocated upon the estate of his debtor in liquidation, under a voluntary assignment, for the full amount of his claim, but is obliged to deduct any sums he may have received from other parties liable on such notes, or which he may have realized upon the goods; and it does not matter at what time such sums have been received on account, provided it is before the day appointed for the distribution of the assets of the estate on which the claim is made." The decision is based on the ground that sums realized upon the collateral operate as payment *pro tanto*. The supreme court affirmed the decision of the Queen's Bench.

The case of Doolittle v. Smith was decided by the Supreme Court of Iowa, January 21, 1898 (73 N. W. 867). In an assignment case, after proof by a creditor, she realized a large sum upon her collaterals. The court cite Amory v. Francis, Wurtz v. Hart, and Bank v. Lanahan, *supra*, and hold that she was entitled to dividends on the balance only after applying the proceeds of her collaterals.

In The State of Nebraska v. Nebraska Savings Bank, 40 Neb. 342, the question arose on the distribution of the assets of an insolvent state bank. The court, after a full discussion of the question, in which they approve Amory v. Francis and *In re* Frash, *supra*, hold that collaterals, realized upon before distribution, must be deducted and dividends made only on the balance due, and that the creditor must surrender to the receiver the collaterals to be collected or disposed of as the court may order for the

benefit of the creditor. There was no statute bearing on the subject. Referring to the contention that the creditor should be allowed to draw dividends on his full claim, the court say, p. 350: "The secured creditor would obtain an advantage over the unsecured one, to which no rule of law or equity entitles him, and which can not be accorded him without working injustice to other parties."

The following authorities hold or approve the third rule that the creditor shall deduct from his claim the proceeds of any security realized before proving or sending in his claim to the official liquidator:

Furness v. Union National Bank, 147 Ill. 570.
Levy v. The Chicago National Bank, 158 Ill. 88.
Sohier v. Loring, 6 Cush. 548.
In re Meyers, 78 Wis. 615.
Kellock's Case, 3 L. R. Chan. App. 769.
In re Barned's Banking Co., 5 L. R. Chan. App. 18.
Fottrell v. Kavanagh, 10 Irish Rep. Eq. S. 256.
Eastman v. Bank of Montreal, 10 Ontario Rep. 79.
Cooper v. Molson's Bank, 26 S. C. Can. 611.

In Furness v. Union National Bank the court say, p. 573: "The creditor has a right to prosecute his claim for the full amount against the estate of the deceased debtor in the hands of the administrator, as he had a right to prosecute it for the full amount against the debtor when alive. Of course this right is subject to the condition that the whole amount of his claim is due to him when he files and proves it. If he has realized upon his collateral before

filing and proving his claim, he voluntarily parts with the double right secured to him by the law, and can only proceed for what is actually due to him; that is to say, for what remains of his claim after deducting the amount realized from the collaterals."

In Levy v. The Chicago National Bank, 158 Ill. 88, the English and American authorities are reviewed, and the court expresses its conclusion as follows, p. 102: "Our conclusion is, that the amount upon which the secured creditor is entitled to receive dividends from the assets of the insolvent estate is the amount actually due to the creditor when he files his proof of claim or presents his claim under oath; that the subsequent hearing upon objections or exceptions should be directed to the inquiry as to what was due at that date; that the amount due at that date is to be ascertained by the deduction from the principal debt of all payments made before that date, whether realized frcm collaterals or otherwise, but that amounts realized from collaterals after that date are not to be deducted, subject always to the qualification that the dividends received from the general assets and the amounts realized from the collateral security shall not together exceed the amount due the creditor upon his claim." The court expressly dissent from the statement of the learned judge who delivered the opinion in The Chemical National Bank v. Armstrong, 59 Fed. 372, that there is no logical basis for any distinction between the effect of collections made from collaterals after insolvency and before filing proof, and of those made after filing proof. They show that in Illinois, at least, creditors have no such "fixed" equitable ownership in the assets as will prevent its yielding to a payment received by the creditor before he proves his claim.

The plan of proving a fictitious amount—the amount *formerly* due—in order to obtain a dividend large enough

to pay what is *now* due may be logical, but it does not seem to be fair.

The English and Canadian cases cited show that this third rule of distribution is well established in both England and Canada. That is to say, in both countries the creditor must *at least* credit the proceeds of collaterals received *before proving* his claim. In Canada, however, as appears from Thibaudeau v. Benning, 20 S. C. Can. 110, cited above under the second rule, the creditor must also deduct all proceeds of collaterals received before *dividends*, prorating only on the balance. In England it seems to be settled by Kellock's Case, L. R. 3 Chan. App. 769, that proceeds of collaterals received after proof are not to be credited. The principal reason assigned is that the official liquidator might be tempted to delay dividends, hoping for the creditor to realize on his collaterals. I respectfully submit that this danger is not so imminent as the corresponding danger of *creditor* and *collateral debtor* agreeing to defer payment of collateral under the rule in Kellock's Case. The delay of the officer (liquidator or receiver) is *illegal*—a breach of his sworn duty. The delay of the others, creditor and collateral debtor, is but the legitimate adjustment of their private affairs so as to enable the creditor to reap the reward of a larger dividend offered by the law. He could well afford to be more lenient to the collateral debtor.

In re Barned's Banking Co., 5 L. R. Chan. App. 18, has a special bearing on the case at bar, as it is there held that proceeds realized from collaterals before *formal proof* to the official liquidator must be deducted from the amount on which dividends are based, although *before the proceeds were realized* the claim had been sent by a notary public to the official liquidator for *payment.*

The fourth rule, that the creditor shall be permitted to draw dividends on the full amount of his claim as it existed at the time of insolvency, regardless of payments since received from collaterals before or after time of proof, is supported by several cases in Pennsylvania. In The Chemical National Bank v. Armstrong the court supposed that Allen v. Danielson, 15 R. I. 481, was also a direct authority in support of the doctrine, but it clearly appears from the opinion of the court in that case, p. 483, that the mortgaged property by which the creditors were secured was sold *after* the first dividend, so that it is improbable that the question was before the court. Neither the learned court nor the able counsel in The Chemical National Bank v. Armstong were able to find any other authority for the proposition.

If the Pennsylvania doctrine is sound and applicable to the receivers of insolvent national banks, it is decisive of the question. But I respectfully submit it is not sound.

The foundation case cited and followed is Miller's Appeal, 35 Pa. St. 481. After an assignment in trust for creditors, one of the creditors attached a legacy, which was left to the insolvent debtor after the assignment, and having applied it on his debt, was thereafter permitted to prove for the original amount of his claim. Mr. Justice Strong says, p. 483: "It is not as a creditor that he is entitled to a distributive share of the trust fund. His rights are those of an *owner* by virtue of the deed of assignment. The amount of the debt due to him is important only so far as it determines the extent of his ownership. The reduction of that debt, therefore, after the creation of the trust and after his ownership had become vested, it would seem, must be immaterial. If it be suggested that the whole debt due Miller might have been paid by the

assignor after the assignment and before distribution, the answer is at hand: Miller's right to participate in the distribution at all is only a right in equity, it requires the aid of a chancellor, and that aid will not be given if the whole debt is paid."

That creditors have equitable rights in the trust fund; that they are in a sense *cestuis que trustent*, is clear. But that they are *owners*, with an ownership so fixed and absolute that it is entirely independent of the debt out of which their interest grows, unless the whole debt is extinguished, is not so clear. If "the amount of the debt due to him is important *only as it determines the extent of his ownership*," how can that debt have sufficient force and validity to be the foundation of an action to subject the legacy to its payment? If it is not *all* in full force and validity, how much of it is? Is it not clear that if the legacy had been not more than sufficient to pay the whole debt, the creditor could have recovered the full legacy? If, however, the debt *is* in full force, how can the creditor retain his claim unimpaired and undiminished, and at the same time *own* some of his debtor's property? Does the law or equity transfer property from the debtor to the creditor without affecting the debt? Again, suppose that the assets in the hands of the assignee should be stolen or lost by a cyclone, upon what *owner* would the loss fall? Such loss would disappoint and injure the creditor, but would no more affect his claim than if the property were being transmitted by the debtor's own agent instead of through the agency of the law.

I respectfully submit that the answer of the learned Justice to his own suggestion, about the effect of full payment of the debt on ownership, is not sufficient. It says, in

effect, that although this doctrine leads to a logical absurdity, the chancellor can avoid the consequences. If the debt, as it is reduced by payment, is permitted to measure the right to dividends, there will be no absurd consequences to require the chancellor's intervention.

The difference between paying the creditor a dividend upon his *whole claim* when it has *all* been collected, and paying the same dividend when a *part* of the debt is in his own pocket, seems to be not a distinction in equity, but simply a difference in the *degree* of injustice to other creditors.

When it is once admitted, as it is in Pennsylvania, Assigned Estate of Wilhelm, 182 Pa. St. 281, above cited, that the principal debt is in part *extinguished* by the proceeds of collateral received by the creditor, the whole argument, based on the right of the creditor to follow the assets as he could have followed the debtor, is inapplicable, and the logical advocate of the collaterally secured creditor's right so to manipulate his claim as to obtain dividends on the original amount is forced to resort to some technical theory which will give the creditor rights independently of the *debt*. The "fixed ownership" theory meets the situation. Any theory, which permits a creditor to obtain the full benefit of a whole claim when part of it is gone, seems utterly subversive of that nursery maxim of political economy, "You can not eat your cake and have it too."

Although this Pennsylvania doctrine has been repeatedly asserted by its courts, they have thrice failed to enforce the rigor of its logic.

In Sweatman's Appeal, 150 Pa. St. 369, a prospective landlord, at the request and for the accommodation of a prospective tenant, purchased a lot and erected a building

for the tenant, under an agreement that the tenant should lease the premises for a term of years to compensate the landlord. The lease was executed, binding upon executors, administrators and assigns, with covenants to pay rent and to terminate the lease for breach of covenants or conditions, without release of damages for such breach. Prior to the termination of the lease the tenant made an assignment for the benefit of his creditors, and the assignee abandoned the premises. The landlord was permitted to prove a claim for damages for failure to compensate him for his investment. Here there was no breach of any agreement *at the time of the assignment.* If creditors at the time of the assignment have a fixed ownership it is difficult to see how the landlord had any standing as a creditor.

In the Assigned Estate of Wilhelm, 182 Pa. St. 281, above cited, as to the effect on the debt of realizing on collaterals, the chancellor did even more than was suggested he might do by Mr. Justice Strong, in Miller's Appeal. The court would not permit the creditor, whose claim was partly paid by collateral realized after the assignment, although the creditor even refused to apply the proceeds of the collateral on his claim, to claim *interest* against the estate, to which he would have been entitled but for the payment. A very just decision, but justice came from the chancellor and not from the "fixed ownership" doctrine.

In a case decided by the Pennsylvania Superior Court, composed of seven judges, *In re* Wetzler's Estate, 3 Pa. Sup. Ct. 435, a creditor had obtained judgment against his debtor and levied execution on personal property, after which the debtor assigned for the benefit of his creditors. Before dividend the creditor realized part of his claim out

of the sale on execution. With this in his pocket he asked for a dividend on his whole claim. The court unanimously held that it should be deducted and his dividend paid only on the balance. The decision was based, not on the ground that the levy was a satisfaction *pro tanto*, but on the ground that the personal property levied upon did not pass to the assignee.

It seems that the Pennsylvania theory does not work smoothly in its practical application.

In favorable contrast with the case of Miller's Appeal is the case of Combs v. Union Trust Co., 146 Ind. 688. There the creditor, after an assignment in Indiana, went into another State and collected part of his claim by attaching property, which, however, was owned by the debtor at the time of the assignment. The Indiana court applied the proceeds, not on his claim, but on his *dividends* in the assignment case.

But if the Pennsylvania theory is correct as to an assignee in insolvency, it ought not to be applied to the receiver of a national bank and to the Comptroller of the Currency, who is required to make "a ratable dividend," and has not the power of a chancellor to neutralize the injustice of a logical theory.

But this is not a new question to this honorable court. It was involved in a case of great importance where the interests of the United States required the application of the rule that dividends should be paid by the receiver of a national bank regardless of collateral realized upon after the insolvency of the bank. This plan of distribution was

not suggested by counsel in the case, but the language of Mr. Justice Field indicates how the suggestion would have been treated if made.

Cook Co. National Bank v. The United States, 107 U. S. 445.

So f r as the case cited bears on the question, the facts are as follows: At the time of the suspension of The Cook County National Bank, January, 1875, the Treasury Department of the United States held $150,000, par value, of United States bonds belonging to the Bank *as security* for all public moneys therein deposited. These bonds were, after the receivership, duly sold for $174,544.52 by the Treasury Department, and after paying *in full* the amount on deposit with the Bank to the credit of the Treasurer of the United States, there remained a balance of $19,239.05. At the time of failure the Bank had on deposit, of postal funds, $24,900, and of money-order funds, $14,684, deposited by the Deputy-Postmaster of Chicago. The Treasury Department applied the balance, $19,329.05, ratably on these two funds, leaving a balance due from the receiver on account of the two funds of $20,344.95. The officers of the United States being in doubt whether the said balance was a preferred debt under the U. S. Statutes, the United States filed a bill in the Circuit Court of the United States for the Northern District of Illinois against the Bank and its receiver, asking for a decree directing the disposition of the funds of the Bank in the control of the Treasury Department for distribution. The defendants treated the bill as if filed to obtain a *priority* in the payment of the *balance* due for postal funds and money-order funds. A demurrer to the bill was overruled by the Circuit Court and appeal was taken to the Supreme Court of the United

States, where the demurrer was sustained and the cause remanded for a dismissal of the bill. While the only question expressly considered was the question of priority, yet the scope of the bill was large enough to authorize a decree for a dividend upon the original amount of the claim for postal and money-order funds, if the United States was entitled to that relief, but no such decree was entered. Mr. Justice Field says, p. 449 (italics mine): "With these provisions for security against possible loss for moneys deposited, it would seem only equitable that the Government should call for such security, and, *if it prove insufficient*, take the position of other creditors in the distribution of the assets of the bank *in case of its failure.*"

The italicized words indicate pretty strongly that the learned Justice did not disapprove of the treasurer's act in first exhausting the security and paying one claim *in full*, thereby disabling it, even under the Pennsylvania theory, from participating in dividends, nor is there the slightest suggestion that the claim for postal and money-order funds should be recognized for dividends in any larger sum than the amount due after applying the balance of the proceeds of the security.

While it does not appear in the record what assets the receiver held or what dividends he paid, it does appear that if the officers of the Treasury Department had withheld the full security, as appellee in the case at bar desires to do, a dividend of only eleven percent on the entire claims, together with the proceeds of the security, would have paid all the claims of the United States in full.

I respectfully submit, therefore, that the rule cf distribution adopted in this cause in the United States Circuit Court of Appeals for the Fifth District is unsound in

principle and contrary to the great weight of authority, and that the judgment of said Court should be reversed.

Respectfully submitted,

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